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Addendum StartPage: 0

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APPLICATION OF SOUTHWESTERN ELECTRIC POWER COMPANY FOR AUTHORITY TO CHANGE RATES	§ § §	BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS

DIRECT TESTIMONY

OF

STEVEN D. HUNT

ON BEHALF OF
EAST TEXAS ELECTRIC COOPERATIVE, INC.
AND
NORTHEAST TEXAS ELECTRIC COOPERATIVE, INC.

MARCH 31, 2021

306

TABLE OF CONTENTS

DIRECT TESTIMONY OF STEVEN D. HUNT

I. EXPERIENCE AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Steven D. Hunt. My business address is 111 N. Orange Avenue, Suite 710, Orlando, Florida, 32801.

Q. PLEASE OUTLINE YOUR FORMAL EDUCATION.

A. I earned a Bachelor of Science in Business degree with a major in Accounting from Virginia Tech in 2001. Additionally, I earned a Master's degree in Accounting and Information Systems from Virginia Tech in 2002.

Q. ARE YOU A LICENSED CERTIFIED PUBLIC ACCOUNTANT?

A. Yes. I am a certified public accountant licensed in Washington, D.C.

Q. WHAT IS YOUR PRESENT POSITION?

A. I am a Senior Project Manager for the firm GDS Associates, Inc. ("GDS").

Q. PLEASE STATE YOUR PROFESSIONAL EXPERIENCE.

A. From June 2002 through August 2020 I was employed by the Federal Energy Regulatory Commission ("FERC"). At FERC, I worked entirely in the Regulatory Accounting program as an accounting analyst, manager, deputy Chief Accountant, and Chief Accountant, working directly with FERC's rate and legal programs on electric and gas rate applications, accounting request filings, merger applications, and accounting guidance letter orders. As Chief Accountant and Director of the Division of Audits and Accounting ("DAA") in the FERC Office of Enforcement, I served as FERC's principal accounting and financial authority with respect to its electric, natural gas, and oil regulatory programs for nearly 3 years. I also supported the FERC audit program for 10 years as a project manager, DAA Deputy Director, and DAA Director. I was directly involved in the initial risk assessment processes to determine audit focus areas, initial and supplemental discovery requests and interrogation, presenting findings of fact through draft audit reports, defending the findings of fact based on evidentiary record and FERC precedent, and drafting final public audit reports that present to scope of audit work, audit methodologies, and findings and recommendations. Through these experiences, I developed expertise evaluating ratemaking concepts and precedent, utility operations, customer concerns, utility needs, and financial accounting and income tax requirements to identify and resolve macro and micro regulatory issues. For 13 years, I represented FERC's accounting and audit programs externally through frequent public speaking engagements at industry conferences and meetings.

Since Fall 2020, I have been a consultant with GDS providing regulatory accounting and ratemaking support to complex regulatory issues of state and FERC jurisdiction.

Q. WOULD YOU PLEASE DESCRIBE GDS?

A. GDS is an engineering and consulting firm with offices in Marietta, Georgia; Austin, Texas; Auburn, Alabama; Manchester, New Hampshire; Madison, Wisconsin; and Orlando, Florida. GDS has over 185 employees with backgrounds in engineering, accounting, management, economics, finance, and statistics. GDS provides rate and regulatory consulting services in the electric, natural gas, water, storm, and telephone utility industries. GDS also provides a variety of other services in the electric utility industry including power supply planning, generation support services, energy procurement and contracting, energy efficiency program development, financial analysis, load forecasting, and statistical services. Our clients are primarily privately-owned utilities, publicly owned utilities, municipalities, customers of investor-owned utilities, groups or associations of customers, and government agencies.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY REGULATORY COMMISSIONS?

A. No. I have devoted substantially all my entire 19-year career to public service at FERC as advisory staff. Nevertheless, I am extremely experienced presenting accounting and cost-of-service facts, rate analysis, and ratemaking recommendations in proceedings before FERC. I served as the FERC Chief Accountant and Director of the Division of Audits and Accounting in the Office of Enforcement for nearly 3 years and in prior roles served as the Deputy Chief Accountant, Accounting Manager, and Senior Accountant. In these roles I routinely provided expert explanations and recommendations on the application of FERC accounting regulations and cost-of-service ratemaking policy and regulations in various rate proceedings, accounting filings, and audit proceedings. The expert advice was provided to FERC commissioners and all levels of senior leadership through various detailed written memoranda and orally in group project meetings. Furthermore, under FERC delegated authority I issued approximately 350 letter orders on accounting filings by FERC jurisdictional entities and published four accounting guidance letters.

As director of FERC's audit program, I worked closely with my audit teams to draft and issue 27 audit reports presenting the scope of audit work completed, findings of non-compliance, and recommendations for remedial actions. Prior to becoming audit director, I supported the FERC Chief Accountant by actively participating in the drafting and issuance of dozens of FERC audit reports from 2013 – 2017. There were no audit reports, accounting letter orders, or accounting guidance letter orders overturned by FERC through rehearing or otherwise under my leadership.

II. INTRODUCTION

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am testifying on behalf East Texas Electric Cooperative, Inc. ("East Texas" or "ETEC") a generation and transmission ("G&T") cooperative and Northeast Texas Electric Cooperative, Inc. ("NTEC"), also a G&T cooperative. Both cooperatives are currently wholesale customers of Southwestern Electric Power Company ("the Company" or "SWEPCO"). Hereinafter, both cooperatives will be referred to as the "Cooperatives."

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. The purpose of my testimony is to address all or portions of issues 5, 6, 21, 22, 23, 24 29, 68, 69, 70 and 71 in the Commission's Preliminary Order.

Q. WAS YOUR TESTIMONY AND THE INFORMATION CONTAINED WITHIN IT PREPARED BY YOU OR BY KNOWLEDGEABLE PERSONS UPON WHOSE EXPERTISE, JUDGEMENT, AND OPINIONS YOU RELY UPON IN PERFORMING YOUR DUTIES?

A. Yes. All the analysis described in my testimony, that is not expressly described as being performed by SWEPCO or others, was performed by myself and GDS colleagues working under my supervision and direction.

Q. ARE THE OPINIONS AND INFORMATION CONTAINED IN YOUR TESTIMONY TRUE AND CORRECT TO THE BEST OF YOUR KNOWLEDGE AND BELIEF?

A. Yes.

Q. PLEASE DESCRIBE SWEPCO'S APPLICATION AND PROPOSAL

A. On October 14, 2020, SWEPCO filed an application for authority to change rates with the Public Utility Commission of Texas in accordance with Subchapter C of Chapter 36 of the Public Utility Regulatory Act ("PURA") and 16 Tex. Admin, Code ("TAC") section 22.243(b). SWEPCO's rate proposal seeks to increase its annual Texas retail base-rate revenue requirement to $534,165,103, which is a 30 percent increase over its current revenue requirement. SWEPCO calculated this revenue requirement increase using an overall rate of return of 7.22 percent. SWEPCO uses a test year ending March 2020 as its test year and proposes an April 1, 2021 beginning to its rate year. Among other matters, SWEPCO proposes a certain rate recovery provisions for the Dolet Hills Power Station ("Dolet Hills") that will be retired from service in 2021.

Q. WHAT WILL BE THE FOCUS OF THIS TESTIMONY?

A. This testimony will focus on the appropriate rate treatment for Dolet Hills; address whether SWEPCO's proposal to offset the unrecovered balance of Dolet Hills with the regulatory liability related to excess accumulated deferred income taxes ("Excess ADIT Liability") is in the public interest and consistent with PURA and Commission rules; and whether adjustments are necessary to SWEPCO's depreciation expense to properly reflect the retirement of Dolet Hills.

Q. PLEASE PROVIDE ADDITIONAL DETAILS ON SWEPCO'S RATE TREATMENT OF DOLET HILLS.

A. SWEPCO is seeking to create a regulatory asset to include the remaining book value of Dolet Hills and to reduce the regulatory asset by the Excess ADIT Liability. This liability is comprised of the Texas portion of SWEPCO's unprotected excess ADIT and amortized balance of protected excess ADIT. SWEPCO further proposes that the remaining value of Dolet Hills less the Excess ADIT Liability be depreciated over a four-year period. SWEPCO proposes to retire Dolet Hills following the 2021 peak season but no later than December 31, 2021 (approximately 5 to 9 months after the beginning of the rate year). SWEPCO also proposes to include all non-fuel operating costs of Dolet Hills in the proposed rate. Finally, SWEPCO proposes to increase the depreciation expense for Dolet Hills included in the proposed rate by 23 percent or $1,909,171.

Q. DO YOU AGREE WITH SWEPCO'S PROPOSED RATE TREATMENT FOR DOLET HILLS?

A. No. I disagree with SWEPCO's proposed rate treatment of Dolet Hills for several reasons. First, I find that SWEPCO needlessly intertwines the flow-back of the Excess ADIT Liability and the rate treatment for Dolet Hills. Second, I believe the proposed 4-year amortization of the unrecovered Dolet Hills costs is not in the public interest nor consistent with PURA and Commission rules. If the Commission determines the Dolet Hills early retirement to be prudent and eligible for rate recovery post-retirement, I recommend the unrecovered generating station be recovered over the remaining life of the composite group of coal and lignite plant assets. Next, I do not believe that SWEPCO's inclusion of the entire operating cost for Dolet Hills, without any regulatory adjustments, is in the public interest since it will be retired months after the beginning of the rate year. I recommend a regulatory liability be created to include the Dolet Hills operating expenses recovered after the plant is retired, which can be applied against the unrecovered balance of Dolet Hills in a future rate proceeding. Finally, I find SWEPCO's proposed 23 percent increase to the depreciation expense for Dolet Hills to be unsupported and unnecessary.

Q. DO YOU AGREE THAT SWEPCO'S DECISION TO RETIRE DOLET HILLS WAS A PRUDENT MANAGEMENT DECISION?

A. I have no opinion on the prudency of SWEPCO's decision to retire Dolet Hills. However, to the extent the Commission finds the retirement prudent and allows for recovery of the remaining book value of Dolet Hills, I believe the Commission should consider and implement changes to SWEPCO's proposed rate treatment provided in this testimony to ensure the rate recoveries are in the public interest.

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND RECOMMENDATIONS REGARDING SWEPCO'S APPLICATION.

A. Based on my review and analysis, I have reached the following conclusions and recommendations:

(1) SWEPCO should flow-back the Excess ADIT Liability over a four-year period and the rate treatment of excess ADIT should be treated as a stand-alone rate matter.

(2) SWEPCO should amortize the remaining book value of Dolet Hills over the expected remaining life of assets in its composite depreciation group.

(3) SWEPCO should be required to create a regulatory liability for operating costs included in revenue requirement that are recovered after Dolet Hills is retired.

(4) SWEPCO should not recover the estimated costs of abandonment and demolition until the next rate case when costs become known.

(5) SWEPCO should exclude the $1,909,171 increase to depreciation expense for Dolet Hills.

I estimate the total impact on the revenue requirement of these recommendations in Section VII.

III. EXCESS ACCUMULATED DEFERRED INCOME TAXES

Q. EXPLAIN SWEPCO'S PROPOSED TREATMENT OF EXCESS ACCUMULATED DEFERRED INCOME TAXES.

A. SWEPCO determined the amount of excess ADIT resulting from the Tax Cuts and Jobs Act of 2017 and computed the amount relating protected and unprotected ADIT. As of the end of test year, the Texas-jurisdictional portion of protected and unprotected excess ADIT was $121,725,475 and $17,337,163, respectively. SWEPCO proposes to offset the Texas retail portion of the remaining book value of Dolet Hills with two Tax Cut and Jobs Act ("TCJA") related regulatory liabilities: (1) the Texas-related balance of unprotected excess ADIT and (2) the Texas-related amount of protected excess ADIT amortized between January 1, 2018 and the anticipated date new rates in this proceeding become effective, i.e., April 2021 (collectively, "Excess ADIT Liability").[1]

Q. IS SWEPCO'S PROPOSED TREATMENT OF THE EXCESS ADIT AS AN OFFSET TO THE DOLET HILL REQUIRED BY THE COMMISSION?

A. No. The Commission did not require SWEPCO to use any excess ADIT amounts as an offset to specific proposed recoveries. The Commission stated in SWEPCO's last rate case that the regulatory treatment for excess ADIT would be addressed in SWEPCO's next case.[2]

Q. WHAT IS THE RELATIONSHIP OF EXCESS ADIT WITH THE DOLET HILLS POWER STATION?

A. There is no direct relationship between the remaining book value of Dolet Hills and the Excess ADIT Liability.

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[1] Direct Testimony and Exhibits of David Hodgson at 24 (Oct. 14, 2020); Direct Testimony and Exhibits of Michael Baird at 48 (Oct. 14, 2020).

[2] Docket No. 46449, *Application of Southwestern Electric Power Company for Authority to Change Rates*, Order on Rehearing at 58, Ordering Paragraph 10 (Mar. 19, 2018).

Q. IS IT NECESSARY TO ADJUST THE REMAINING BOOK VALUE OF DOLET HILLS BY THE EXCESS ADIT LIABILITY?

A. No. Treating the Excess ADIT Liability separately from the computation of the remaining book value of Dolet Hills should not change the timing of excess ADIT flow-back for SWEPCO. Also, the amortization period for the remaining book value of Dolet Hills is a separate rate matter that should receive a rate treatment independent of the flow-back of the Excess ADIT Liability.

Q. HOW SHOULD THE EXCESS ADIT LIABILITY BE INCLUDED IN SWEPCO'S RATES?

A. The Excess ADIT Liability consists of unprotected excess ADIT amounts and the amount of previously amortized protected ADIT. These amounts are eligible to be refunded to customers as soon as practicable without any risks for violating the normalization requirements of the Internal Revenue Code. Given SWEPCO has indicated that the anticipated time between rate cases is four years, it should amortize the Excess ADIT Liability over four years.[3] Additionally, the Excess ADIT Liability should continue to be a reduction to rate base until it is fully returned to customers. As a result, SWEPCO's Excess ADIT Liability will be fully returned to customers before its next rate case.

IV. DOLET HILLS AMORTIZATION

Q. IS IT PREMATURE FOR SWEPCO TO BEGIN THE AMORTIZATION AND RECOVERY OF REMAINING BOOK VALUE OF DOLET HILLS WHILE IT IS STILL OPERATING?

A. Yes. Cost-of-service ratemaking principles afford a utility to recover its costs of operating utility plant assets and estimates of cost of removal during the period the asset provides service. This is commonly referred as the "used and useful" principle. Once utility plant assets are abandoned and no longer providing utility service, the costs are generally

[3] Direct Testimony and Exhibits of Michael Baird at 49.

excluded from rate determinations. However, in certain circumstances, like the prudent premature retirement of a generating plant, the Commission may allow rate treatment for unrecovered investments in retired assets. Here, SWEPCO states that the early retirement of the Dolet Hills is a prudent management decision and proposes to begin recovering its estimated unrecovered investment as of April 2021, the effective date of the new proposed rate. As of that date, Dolet Hills is expected to still be operating and in service. SWEPCO states that it intends to operate the Dolet Hills generating station through the peak energy season but no later than December 31, 2021. Accordingly, SWEPCO intends to begin collecting the remaining book value of Dolet Hills while it is still in service and recovering depreciation expense, operation and maintenance expense, and return on the same asset. This is improper. SWEPCO should not commence the recovery of the remaining value of Dolet Hills prior to the date it is actually retired and abandoned. There are reliability considerations, for example, and unforeseen circumstances that could lead to Dolet Hills remaining in service longer than anticipated. Accordingly, SWEPCO should seek recovery of the remaining book value of Dolet Hills in its next rate case after it is retired.

Q. DO YOU HAVE AN ALTERNATIVE PROPOSAL FOR THE AMORTIZATION OF THE REMAINING BOOK VALUE OF DOLET HILLS?

A. Yes. To the extent it is determined that the recovery of the remaining book value of Dolet Hills should be included in the current rate proceeding there are several considerations that should be made to ensure the resulting rate is reasonable. First, the amortization of the remaining book value of Dolet Hills cannot be 4 years as proposed and should be determined in a manner consistent with Commission precedent. Second, the cost of removal and demolition of Dolet Hills should be deferred as a regulatory asset for consideration in a future rate case. Finally, the recoveries of the operating costs of Dolet Hills should be tracked as a regulatory liability, as discussed in detail in Section V.

Q. WHAT IS A REASONABLE TIME TO AMORTIZE THE REMAINING BOOK VALUE OF DOLET HILLS?

A. Under the accounting requirements of the FERC Uniform System of Accounts, a plant retirement is recorded by decreasing the plant asset account (FERC Account 101) by the original cost of the asset and increasing the accumulated depreciation account (FERC

Account 108) by the same amount. Additionally, any net salvage costs associated with the retired asset is recorded in the accumulated depreciation account.[4] The Commission has explained that the result of this accounting is that the amount of plant investment and net salvage costs not recovered through depreciation expenses remains on the company's books as a reduction (debit balance) to accumulated depreciation.[5] As such, the amount is incorporated in future determinations of depreciation on the composite group of assets over its average remaining life. When there are significant unrecovered costs of a prematurely retired asset, the FERC Uniform System of Accounts permits the unrecovered costs to be recorded as a regulatory asset when approved by the Commission.

SWEPCO proposes to treat the remaining book value of Dolet Hills as a regulatory asset. However, SWEPCO's decision to record the cost as a regulatory asset should not result in an acceleration of the amortization period compared to the rate effect of recording the unrecovered amount in accumulated depreciation. Accordingly, the Commission should conclude that the remaining book value of Dolet Hills should be amortized over the average remaining life of the composite group for coal and lignite fired generating assets.

Q. WHAT IS THE AVERAGE REMAINING LIFE OF THE COMPOSITE GROUP OF COAL AND LIGNITE FIRED GENERATING ASSETS?

A. SWEPCO depreciates its generating assets under the composite method of depreciation using the Average Remaining Life Method.[6] According to SWEPCO, the Average Remaining Life method recovers the original cost of the plant, adjusted for net salvage, less accumulated depreciation over the average remaining life of the plant.[7] The composite depreciation rate is based on an average service life for all depreciable assets in the group. The use of an average service life assumes automatically that some assets in the group will

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[4] *See* 18 C.F.R. Part 101, Electric Plant Instruction No. 10, Additions and Retirements of Electric Plant.

[5] Docket No. 46449, *Application of Southwestern Electric Power Company for Authority to Change Rates*, Order on Rehearing at 20 (Mar. 19, 2018).

[6] Direct Testimony and Exhibits of Jason Cash at 2 (Oct. 14, 2020).

[7] Direct Testimony and Exhibits of Jason Cash at 6.

have an actual service life shorter than the average and so accrue less depreciation than the average, while other assets in the group will have an actual service life longer than the average and so accrue more depreciation than the average. SWEPCO proposes composite depreciation rates for all of its coal and lignite production plant at 2.567 percent or an average remaining life of 39 years. This composite depreciation rate includes in its average a proposed 2.991 percent or average remaining life of 33 years for Dolet Hills. These values provide a meaningful starting place for determining an amortization period for the remaining value of Dolet Hills in a manner that is reasonable and consistent with the public interest.

Q. IS RATE RECOVERY OVER THE AVERAGE REMAINING LIFE OF THE COMPOSITE GROUP CONSISTENT WITH COMMISSION PRECEDENT?

A. Yes. In SWEPCO's last rate case in Docket No. 46449, it proposed to recover the remaining book value of the Welsh unit 2, which was retired in April 2016. The Commission found that it was reasonable for SWEPCO to recover the remaining undepreciated balance of Welsh unit 2 over the 24-year remaining lives of Welsh units 1 and 3. In reaching this conclusion, the Commission noted that the Welsh unit 2 facility was no longer producing electricity and not used and useful and that allowing SWEPCO to have a return of, but not on, its remaining investment balanced the interest of ratepayers and shareholders. Accordingly, the Commission found the recovery of the undepreciated balance of prematurely retired plant over the average remaining life of the assets by which it belongs was reasonable and appropriate, after concluding that the retirement was prudent.

Q. DOES THIS ALTERNATE PROPOSAL INCLUDE DOLET HILLS REMOVAL AND DEMOLITION COSTS?

A. No. SWEPCO proposes to include approximately $15 million in removal and demolition costs based on estimates. SWEPCO states that it will record the actual cost of removal and salvage proceeds received (net salvage) after the retirement of Dolet Hills to the undepreciated value of the plant. SWEPCO also states that it will record the value of any remaining materials and supplies, spare parts, and other inventory items associated with Dolet Hills after its retirement to the undepreciated value of the plant. Accordingly, SWEPCO does not know the actual costs of removal and demolition and will not have an accurate cost or estimate until removal and demolition activity begin. It is therefore inappropriate and premature to include these estimated costs in the proposed rate prior to the retirement of Dolet Hills and the incurrence of the costs. For these reasons I believe that the Commission should allow the actual removal and demolition costs to be deferred as a regulatory asset for consideration in the next rate case to the extent the retirement of Dolet Hills is determined to be prudent.

Q. WHAT WOULD BE THE EFFECT OF ACCEPTING SWEPCO'S PROPOSED 4-YEAR AMORTIZATION?

A. SWEPCO proposes to recover $45,364,633 over a 4-year amortization period. The annual rate effect is a rate increase of more than $11.3 million. In the rate application SWEPCO mischaracterizes the rate impact to be $3.7 million annually by masking the true rate impact with the Excess ADIT Liability amortization. However, that liability is required to be returned to customers in this rate case regardless of the early retirement of Dolet Hills and, as discussed in this testimony, must be disconnected from the rate treatment and analysis of Dolet Hills.

V. DOLET HILLS OPERATING EXPENSES

Q. IS IT APPROPRIATE FOR SWEPCO TO INCLUDE THE OPERATING COSTS OF DOLET HILLS IN RATES?

A. Yes. As of the effective date of the proposed rate, April 1, 2021, Dolet Hills will still be in service and producing electricity. However, SWEPCO has stated its plans to retire Dolet Hills after the peak energy use season in 2021 and no later than December 31, 2021. Accordingly, Dolet Hills will be retired 5 to 9 months after the new rate becomes effective. The cost of operating assets that are used and useful should be included in cost-of-service rates. However, when the operating asset is planned to be retired almost immediately after the rate year begins there could be problematic rate consequences if not mitigated.

Q. WHY IS SWEPCO'S PROPOSAL PROBLEMATIC?

A. Under SWEPCO's proposal the operating costs of Dolet Hills will continue to be charged in rates until the next rate case occurs, which it estimates to be four years. For SWEPCO's proposed rate to be reasonable, it must be assumed that the costs associated with operating Dolet Hills will be replaced with new costs not already factored into the rate in 5 to 9 months after the beginning of the year. Absent this assumption, SWEPCO will continue to charge customers for the operating costs of Dolet Hills after it is retired. This type of issue arises in situations where a major asset is planned to be removed from service shortly after the commencement of a new stated rate. In these situations, assumptions that new costs will arise that will generally displace other costs no longer incurred seem doubtful and has not been demonstrated by SWEPCO. This reality is complicated by SWEPCO's proposal to compute the remaining book value of Dolet Hills based on an estimate end of year 2021 net book value. It is apparent that SWEPCO will be recovering depreciation and other costs associated with Dolet Hills for the duration of the proposed rate.

Q. WHAT IS THE VALUE OF THE DOLET HILLS OPERATING EXPENSES AND RETURN INCLUDED IN THE REVENUE REQUIREMENT?

A. SWEPCO proposes annual depreciation expense for Dolet Hills of \$3,744,724, operation and maintenance expense (excluding fuel and purchased power costs) of \$4,605,714, and a return of approximately \$2,194,967 to be included in the revenue requirement. These amounts represent the Texas portion of the related costs and sum to \$10,545,405 annually.

Q. HOW CAN THIS PROBLEM BE MITIGATED?

A. The Commission should require SWEPCO to establish a regulatory liability for the non-fuel operating costs included in the revenue requirement related to Dolet Hills from the month the generating station is retired to the effective date of a new base rate. Then, the regulatory liability can be used to offset the regulatory asset created for the remaining book value of Dolet Hills or other costs.

VI. DOLET HILLS DEPRECIATION EXPENSE

Q. PLEASE EXPLAIN THE CHANGES SWEPCO PROPOSES FOR DEPRECIATION EXPENSE FOR DOLET HILLS.

A. SWEPCO proposes to increase its depreciation rate and expense for Dolet Hills by 23 percent.

Q. HOW DOES SWEPCO EXPLAIN THE INCREASE TO THE DEPRECIATION RATE?

A. SWEPCO does not explain or justify the rationale to the increase to depreciation expense of Dolet Hills.

Q. IS THE INCREASE TO THE DEPRECIATION RATE SUPPORTED BY A DEPRECIATION STUDY?

A. No.

Q. IS THE INCREASE IN DEPRECIATION EXPENSE APPROPRIATE IN LIGHT OF THE EXPECTED RETIREMENT?

A. The increase in depreciation expense is concerning in light of the expected retirement of Dolet Hills months after the beginning of the rate year and the proposal to collect the remaining book value of Dolet Hills. It would be more reasonable for SWEPCO to continue depreciating Dolet Hills based on the last depreciation study and factor that amount into the net book value included in the calculation of the remaining book value of Dolet Hills. It is unnecessary and unreasonable to increase the depreciation rate for ratemaking purposes for Dolet Hills when it will be retired a few months after the rate year begins.

Q. SHOULD SWEPCO CONTINUE TO APPLY THE DEPRECIATION RATE DETERMINED IN ITS LAST RATE CASE?

A. Yes.

VII. CONCLUSION

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND RECOMMENDATIONS REGARDING SWEPCO'S APPLICATION.

A. Based on my review and analysis, I have reached the following conclusions and recommendations:

(1) SWEPCO should flow-back the Excess ADIT Liability over a four-year period and the rate treatment of excess ADIT should be treated as a stand-alone rate matter.

(2) SWEPCO should amortize the remaining book value of Dolet Hills over the expected remaining life of assets in its composite depreciation group.

(3) SWEPCO should not recover the estimated costs of abandonment and demolition until the next rate case when costs become known.

(4) SWEPCO should be required to create a regulatory liability for operating costs included in revenue requirement that are recovered after Dolet Hills is retired.

(5) SWEPCO should exclude the $1,909,171 increase to depreciation expense for Dolet Hills.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATIONS?

A. Based on my analysis, I have computed the following impacts of my recommendations on the proposed revenue requirement:

(1) Flow-back Excess ADIT Liability over a four-year period – No impact. SWEPCO proposed to amortize the Excess ADIT Liability over a four-year period. My recommendation is consistent with SWEPCO's proposal.

(2) Amortize the remaining book value of Dolet Hills over the expected remaining life of assets in its composite depreciation group - $6.7 million decrease to the revenue requirement, representing the difference between SWEPCO's proposed 4-year amortization and a recommended 33-year amortization. The amortized amounts include the Texas-portion of Dolet Hills' net book value or $30.4 million.

(3) Deferral of the estimated abandonment and demolition costs - $3.7 million decrease to the revenue requirement, representing the exclusion of SWEPCO's proposed 4-year amortization of $15 million in estimated abandonment and demolition costs from the revenue requirement.

(4) Regulatory liability for certain Dolet Hills post-retirement operating costs – No impact. SWEPCO will continue the inclusion of Dolet Hills operating costs as proposed. However, after Dolet Hills' retirement, operating costs recoveries will be deferred as a regulatory liability, conservatively estimated at $10.5 million annually.

(5) Exclusion of increase to Dolet Hills depreciation expense - $1.9 million decrease to the revenue requirement, representing the exclusion of SWEPCO's proposed 23% increase to Dolet Hills depreciation expense.

Q. WHAT IS THE TOTAL ESTIMATED IMPACT ON THE REVENUE REQUIREMENT OF THE PROPOSED RECOMMENDATIONS?

A. In total, my recommendations will reduce the revenue requirement by $12.3 million for costs associated with Dolet Hills.

Q. WHAT IS THE FUTURE ESTIMATED IMPACT OF THE PROPOSED RECOMMENDATIONS?

A. It is possible that the remaining value of Dolet Hills, inclusive of actual abandonment and demolition costs, will be included in the development of SWEPCO's next base rate case. Such amounts may be offset with deferred Dolet Hills operating costs recovered post-retirement. For example, if SWEPCO records three years' worth of Dolet Hills operating costs as a regulatory liability to account for the time period between the generation plant's retirement and SWEPCO's next base rate case, the value of that regulatory liability would be conservatively estimated at $31.5 million. This regulatory liability would be used to offset and reduce the future revenue requirement.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.